

# **The BIPARTISAN RETIREMENT SECURITY ACT**

## ***A Comprehensive, Bipartisan Plan to Save Social Security***

***Congressmen Jim Kolbe (R-AZ) and Allen Boyd (D-FL)***



### **DETAILED SUMMARY OF KOLBE-BOYD**



#### **Individual Accounts**

##### **Individual accounts from current payroll taxes**

**Provision:** Provides a payroll tax cut for all working individuals under the age of 55, by diverting 3% of payroll taxes on the first \$10,000 in earnings and 2% of all earnings above \$10,000 up to the wage cap into personal Individual Security Accounts.

**Actuarial impact:** Reduces revenues to the trust fund by 2.16% of payroll.

**Rationale:** Funding individual accounts by using a portion of the existing payroll taxes uses Social Security revenues would prefund future benefit obligations through individual accounts instead of building up assets in the Trust Fund that represent a liability to the general Treasury. Creating individual accounts with current revenues to provide retirement income in the future makes it possible to reduce benefit obligations in the future, when the system faces annual shortfalls. Creating individual accounts outside of the existing payroll tax would either require an increase in payroll taxes or create new obligations on the general Treasury that would create substantial budgetary pressures in the future. Either way, funding individual accounts outside of the existing payroll tax would take resources away from other priorities.

##### **Administration of accounts**

**Provision:** Uses the Thrift Saving Plan model for administering individual accounts. Individuals would be allowed to invest their individual accounts in funds operated by private managers selected through competitive bidding and subject to oversight by the Social Security Investment Board. Investment options would include a stock index fund, a bond index fund and a Treasury securities index fund. Individual accounts could be invested in any combination of these funds.

Once a worker's account balance reaches \$7,500, they would have the option to choose a private investment institution invest their individual account funds. Workers would have to affirmatively choose to leave the TSP model plan and join the private alternative. A worker who is happy with their investment options in the TSP model plan would simply do nothing to continue in their current investments. Financial institutions (including investment firms, credit unions, and insurance companies) would be subject to SEC approval and required to offer broad based, diversified investment funds with low administrative costs. The SEC's regulatory approval would be based on the fund's administrative fee structure, risk profile, and appropriateness as a retirement investment vehicle.

**Rationale:** The TSP model combines the desire for individual ownership of investment accounts with the economies of scale offered by collective trust fund investment. The centralized structure of the TSP model will minimize employer burdens and administration costs of individual accounts. Providing that funds in individual

accounts will be managed by private firms selected through competitive bidding and subject to oversight will protect individuals from the risk of fraud and simplify investment decisions for individuals with limited investment knowledge.

The option of opting out of the TSP model and choosing a private investment manager offers workers the option of expanded investment opportunities but does not force anyone to take on additional risks or responsibility of evaluating private options. The existence of private options that workers could choose if they were unhappy with the management of the TSP program would serve as a check on the operations of the TSP program.

### **Enhanced progressivity for individual accounts**

**Provision:** Provides an additional tax credit that would be deposited into individual accounts for low-income workers. Workers who make voluntary contributions would receive a tax credit equal to \$150 plus 50% of all voluntary contributions up to a cap of \$600 per individual per year. This credit is phased out for wages between \$22,500 and \$30,000 a year. Directs Treasury to establish mechanism to allow workers to divert a portion of their EITC into an individual account and qualify for the additional tax credit.

**Actuarial impact:** None, since the tax credit is funded by general revenues.

**Rationale:** The government match will provide low-income workers with both assistance in building their individual accounts and an incentive to save for their retirement. The requirement that individuals make a voluntary contribution to qualify for the match is designed to avoid creating a new entitlement and to encourage savings. The automatic contribution and government match will substantially reward workers who make even modest contributions on their own, which will send a very strong pro-savings message. Allowing individuals to direct a portion of EITC payments to individual accounts creates a mechanism for workers who have limited disposable income to benefit from voluntary contributions. The phase out of the credit avoids a “cliff effect” as incomes rise.

### **Voluntary Contributions.**

All workers would be permitted to save up to an additional \$2,000 per year through voluntary contributions to individual accounts, although tax credits to supplement voluntary contributions would only be available for lower income workers. Voluntary contributions would be from post-tax dollars, similar to non-deductible IRAs.

**Actuarial impact:** None. This provision also has no budgetary impact, since the voluntary contributions are with post-tax dollars

**Rationale:** Allowing workers to make voluntary contributions to their individual account will provide a retirement savings vehicle for workers who do not have access to a 401(k) plan and who have not established an IRA, and for workers who have reached contributions limits on private retirement savings options and wish to make additional savings for their retirement. This provision will provide higher income workers who will face larger reductions in their defined benefits with the ability to build their individual accounts to offset any potential reduction in retirement income. Voluntary contributions are non-deductible so that the individual security accounts do not provide a tax advantage over private retirement savings options and encourage individuals to shift funds from IRAs or other savings vehicles for tax purposes.

### **Paying for individual accounts**

#### **Changes in benefit to reflect contributions to individual accounts**

**Provision:** Makes progressive changes in the current benefit formula slowly phasing in changes to the benefit formula beginning in 2012 to reduce initial defined benefit levels to correspond with the opportunity

to benefit from individual accounts. The changes in the benefit formula would not affect workers who are within ten years of retirement. The changes in the benefit formula would primarily affect the defined benefit levels for middle and upper income workers, who will have a greater opportunity to benefit from individual accounts. The second two PIA factors would be reduced by 2.5% a year from 2012-2030. All three PIA factors would be reduced by 1.5% from 2031-2060. The income thresholds for the PIA factors would be unchanged.

**Rationale:** The reductions in the PIA factors will reduce future benefit obligations in a progressive manner that reflects the ability of workers to benefit from individual accounts. The reductions in guaranteed benefits will be greater for middle and higher income workers who will accumulate greater amounts in their individual accounts. The reductions are phased in over time as workers have increased time to accumulate funds in their individual accounts. Lower-income workers would not be subject to reduction in initial defined benefit levels until 2031, when changes to the benefit formula gradually begin to affect all workers. However, most low wage earners would continue to be unaffected by benefit changes because of the minimum benefit provision.

For a worker retiring in 2020, the benefit formula changes would increase the defined benefit for a low wage worker by 4%. The defined benefit for an average wage earner would be reduced by 19% and benefits for a maximum wage earner would be reduced by 25% below the benefit levels available under current law.

These reductions DO NOT take into account the balances accumulating in workers' personal accounts. It is expected that workers will generate balances in their individual accounts that will *at least* compensate for the reduction in guaranteed benefit. According the Social Security Administration actuaries, if we fail to enact structural reform, benefits will have to be reduced by 27% in 2038. The benefit cut would increase to 33% by 2075 and continue to worsen.

### **Improve accuracy of Cost of Living Adjustments.**

**Provision:** Improve the accuracy of indexation for all government programs, including Social Security Cost of Living Adjustments and provisions in the tax code indexed to inflation, by using the "superlative index" that the Bureau of Labor Statistics (BLS) began publishing last year which identifies the bias in the official CPI that cannot be corrected in the official CPI. Cost of living adjustments and other indexation of government programs would be equal to the official CPI adjusted to reflect the upper level substitution bias identified by BLS in the superlative index. The superlative index is expected to identify a bias in the official CPI from upper level substitution bias of approximately 0.22%.

**Rationale:** Virtually all economists including Federal Reserve Chairman Alan Greenspan agree that the CPI overstates inflation. The BLS, which calculates CPI, began calculating a "superlative index" that is able to correct for the primary source of the bias in the CPI. This provision adjusting the CPI by the bias identified by the superlative index would correct the overstatement of inflation based on technical findings of experts instead of making an arbitrary legislated reduction in COLAs.

### **Changes to reflect increases in life expectancy and longer working lives**

#### **Eligibility age**

**Provision:** Eliminate the hiatus in the scheduled increase the normal eligibility age, allowing the Normal Retirement Age (NRA) to reach age 67 by 2011.

**Rationale:** This change simply accelerates the increase in the eligibility age that is scheduled under current law by 2021. A modest increase in the eligibility age is a reasonable adjustment in response to increased life expectancy and the declining labor force that will occur in the 21<sup>st</sup> Century.

### **Improved actuarial adjustment for early/late retirement.**

**Provision:** Revise the actuarial adjustment for early/late retirement to reflect the additional payroll taxes individuals pay while working past the Normal Retirement Age and the payroll taxes that a worker who takes early retirement would have paid if he/she continued working until NRA.

**Rationale:** Currently, the delayed retirement credit does not compensate workers for the years of additional payroll taxes individuals pay while working past the Normal Retirement Age. This legislation would revise the actuarial adjustment for early/late retirement to fully reflect this. Improving the actuarial adjustment for early/late retirement would more accurately reward workers who continue working past the normal retirement age.

### **Longevity factor**

**Provision:** Establishes a “longevity factor” that reduces initial benefits based on increases in life expectancy so that total expected benefits over an individual’s lifetime would remain constant. If, for example, life expectancy for an individual retiring at age 65 increases by 10% over current life expectancy, the initial benefit would be reduced by 10%.

**Rationale:** This adjustment reflects the increased number of years individuals will live after reaching the Normal Retirement Age. The initial benefit levels would be gradually reduced as retirees are expected to live longer and therefore receive benefits for a longer period of time, so that the total amount of benefits that an individual receives over their retirement years remains constant over time. This provision has an impact similar to an increase in the retirement age but gives workers flexibility to retire and become eligible for benefits without an explicit increase in the retirement age. This is based on reforms in the Swedish retirement system which gives workers flexibility to decide when they retire and sets benefit levels based on life expectancy at retirement.

### **Increased benefit computation years in the Average Indexed Monthly Earnings (AIME) formula**

**Provision:** Gradually increase the number of computation years in determining benefit levels from 35 years to 40 years. The benefit computation period for the lower wage earner would be capped at 35 years for the lower wage earner in a two earner couple to benefit spouses who leave the workforce for child rearing or other purposes.

**Rationale:** The benefit formula should reflect the longer working lives. This change would modernize the benefit structure to reflect the increases in working lives. Capping the increase for the low-earning spouse in a two couple family will protect spouses, usually women, who leave the workforce for childrearing.

### **Count all years of earnings in AIME formula**

**Provision:** Includes all years of earnings in the benefit formula in order to reward individuals for all income that they earn even if not among their highest 40 years of lifetime earnings.

**Rationale:** This provision rewards individuals for all income that they earn, even if on a part-time basis, and even if not among their highest 40 years of lifetime earnings. This will benefit workers who begin working at low wages at an early age and workers who continue working at lower wages after leaving their primary job prior to retiring.

### **Other provisions to achieve and preserve solvency**

## **CPI Recapture**

**Provision:** Adjusting indexation of government programs to correct for the bias in the CPI would reduce the rate of growth in cost-of-living adjustments and income tax-related parameters of the federal budget. This would create net savings in the non-Social Security budget and accelerate non-Social Security revenue collections. These savings would be transferred to the OASDI trust fund. For the first ten years, the transfers are equal to the CBO estimate of the savings in the non-Social Security budget from the CPI adjustment. After 2010, the transfers are based on estimates of the expected savings in the non-Social Security budget from the CPI adjustment.

**Rationale:** Any adjustment in indexation to correct for the bias in the CPI should be applied fairly to all statutory provisions that are indexed to CPI, since the bias affects all programs equally. Capturing the savings in the non-Social Security budget for the Social Security trust fund provides a self-generating revenue stream for the Social Security trust fund from general revenues that does not rely on additional debt or squeeze other budgetary priorities. The savings from correcting indexation of the tax code provides an extremely progressive source of revenues to replace the lost revenues from the payroll tax cut

### **Recapture revenues from taxation of Social Security benefits.**

**House bill:** Credit all revenue from taxation of benefits to Social Security to the OASDI trust fund. The 1993 budget reconciliation bill diverted a portion of the tax revenue levied on Social Security income to the Hospital Insurance Trust Fund. Between 2010 and 2019, this legislation would slowly phase in the redirection of these taxes back to the Social Security Trust Fund where they belong.

**Rationale:** The revenues from taxation of Social Security benefits have always been directed to the Social Security trust fund. In order to minimize the adverse impact on Medicare of returning Social Security benefit taxes back to the Social Security system, the Commission recommends gradually phasing in this provision over a period of 10 years

### **“Fail-safe” mechanism.**

Protect the program from once again falling out of balance by requiring Congress and the President to consider changes to the program on a timely basis whenever projections show deteriorating fiscal health for the trust fund.

## **Strengthening the safety net in the defined benefit system**

**House bill:** Establishes a new minimum guaranteed minimum benefit for low-income workers more robust than current law. Social Security beneficiaries with at least 20 years of covered earnings would receive a benefit equal to 80% of the poverty level. This benefit would increase by 2% of poverty for each year of covered earnings, until the guaranteed minimum benefit reaches 120% of the poverty level for individuals who worked 40 years or 160 quarters of coverage.

The minimum benefit would be calculated without regard to any other benefit changes, thereby shielding low-income recipients from adverse effects of other measures taken to restore the Social Security system to solvency. Any income from the individual accounts would supplement this guaranteed benefit.

### **Wage cap on payroll tax**

**Provision:** Reform the indexing of the cap on taxable wages to continue the proportion of national wages subject to tax at its current level of 87%.

**Rationale:** Under current law, it is projected that average wages will lag behind total national wage growth, causing the share of total wages subject to Social Security taxes to gradually fall. This provision would prevent a further deterioration of the percentage of total wages subject to payroll taxes. This is a middle ground between proposals that would increase the percentage of total wages subject to payroll taxes above current levels, and the deterioration in the wage base that would result under current law.

**Provision:** Gradually phases in a change in the Social Security bend point factors to increase the progressivity of the guaranteed benefit and reduce poverty among the elderly. The 90%, 32%, and 15% PIA factors would gradually become 90%, 70%, 20% and 15%

**Rationale:** The minimum benefit provision protects low-income workers from the impact of the benefit reductions necessary to achieve solvency and provides a much stronger safety net for the lowest-earning workers that will lift more retirees out of poverty than current law. Any income from the individual accounts would supplement this guaranteed benefit. The changes in the PIA factors will result in some increase in benefit levels for workers in the lowest earning cohorts who do not benefit from the minimum benefit.

► **New provision. Increased benefits for widow(er)s** Starting in 2011, pay surviving spouses 75% of the combined benefit. Limit widow's benefit to no more than the average PIA for retired worker beneficiaries in the prior year. New provision!

► **New provision. Limit spousal benefit for high earner couples.** Limit spousal benefits so that the combined benefits of a married couple do not exceed the maximum PIA for a retired worker beneficiary in the prior year. New provision!